Supreme Court, U.S.
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No. ——

In the Supreme Court of the United States

OCTOBER TERM, 1995

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,
Petitioner,

v.

UNITED STATES OF AMERICA.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITION FOR A WRIT OF CERTIORARI

PETER BUSCEMI *
MARK A. SRERE
MORGAN, LEWIS & BOCKIUS
1800 M Street, N.W.
Washington, D.C. 20036
(202) 467-7190
Counsel for Petitioner

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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QUESTION PRESENTED

The life insurance industry is composed of two segments: stock life insurance companies and mutual life insurance companies. Stock companies typically pay price rebates to policyholders and earnings dividends to shareholders. Under the tax laws, the former are deductible and the latter are not. Mutual companies, which have no shareholders, pay dividends only to their policyholders.

In 1984, Congress enacted Section 809 of the Internal Revenue Code to address a perceived need to "level the playing field" between stock companies and mutual companies. The underlying theory was that some portion of the dividends paid by mutual companies represented a return on policyholders' investment and therefore should be taxed like stock companies' shareholder dividends. To achieve this result, Congress adopted a mathematical formula that adjusts taxable income of mutual companies based on a comparison of the current one-year average of mutual company earnings rates with an adjusted average of stock company earnings rates for the previous three years. Although stock company earnings rates are generally higher in a year-by-year comparison with mutual company earnings rates, earnings rates in the insurance industry vary dramatically from year to year. The average mutual earnings rate for any one year, therefore, may well be higher than an average of stock earnings rates for the three prior years. Accordingly, when the current mutual earnings rate is subtracted from the average stock rate under Section 809's formula, a negative number may result.

The question presented is:

Whether the court of appeals misinterpreted Section 809, and thus authorized taxation of mutual companies at levels higher than those intended by Congress, when it chose to disregard those occasions on which the difference between prior years' average stock earnings rate and the current year's mutual earnings rate is a negative number.

STATEMENT UNDER RULE 29.1

In accordance with Rule 29.1 of the Rules of this Court, petitioner American Mutual Life Insurance Company And Subsidiaries, states that it has no parent company, no subsidiaries (other than a wholly owned subsidiary, American Vanguard Life Insurance Company), and no affiliates. Petitioner further states that the issue presented in this federal income tax case arises in the case of every mutual life insurance company.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
STATEMENT UNDER RULE 29.1	ii
OPINIONS BELOW	1
JURISDICTION	1
STATUTORY AND REGULATORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	2
A. Factual Background	2
B. Section 809	3
C. Procedural History	12
REASONS FOR GRANTING THE PETITION	13
I. THE COURT OF APPEALS IMPROPERLY APPLIED RULES OF STATUTORY INTERPRETATION AND IGNORED THE CLEAR LANGUAGE OF THE STATUTE AS WELL AS THE RECORD IN CONSTRUING SECTION 809 AS IT DID	14
A. The Court Of Appeals Mistakenly Relied On The Heading Of Section 809 In Interpreting The Otherwise Plain Language Of Section 809	16
B. The Court Of Appeals Mistakenly Relied On Section 808 In Interpreting The Otherwise Plain Language Of Section 809	20
C. The Court Of Appeals Misinterpreted Section 809's Use Of The Term "Excess"	26

TABLE OF CONTENTS—Continued

Page

II. THE PETITION SHOULD BE GRANTED BECAUSE IT WILL SAVE JUDICIAL RESOURCES TO RESOLVE THE ISSUE NOW.... 29

CONCLUSION 30

TABLE OF AUTHORITIES

CASES — Page

Atlantic Cleaners & Dyers, Inc. v. United States, 286 U.S. 427 (1932) 28
Brotherhood of Railroad Trainmen v. Baltimore & O.R.R., 331 U.S. 519 (1947) 17
Commissioner v. Engle, 464 U.S. 206 (1984) 24
Commissioner v. Schleier, —— U.S. ——, 115 S. Ct. 2159 (1995) 16
Crooks v. Harrelson, 282 U.S. 55 (1930) 19
Harrison v. Northern Trust Co., 317 U.S. 476 (1943) 29
Maguire v. Commissioner, 313 U.S. 1 (1941) 17
Moore v. United States, 249 U.S. 487 (1919) 20
United States v. Goodyear Tire & Rubber Co., 493 U.S. 132 (1989) 26, 29
United States v. Hill, —— U.S. ——, 113 S. Ct. 941 (1993) 30
United States v. Minker, 350 U.S. 179 (1956) 17
United States v. Temple, 105 U.S. 97 (1882) 19, 20

STATUTES AND RULES

26 U.S.C. § 801 ..... 2, 4
§ 803 2
§ 804 2
§ 805 ..... 2, 4
§ 807 ..... 2, 9, 18, 27
§ 808 ..... 2, 4, 12, 15, 16, 18, 20, 21, 27
§ 809 ..... *passim*
28 U.S.C. § 1254(1) 1
26 C.F.R. § 1.809-9 ..... 2, 19
Announcement 88-47, 1988-12 I.R.B. 56 ..... 2, 11, 28
Revenue Ruling 89-106, 1989-2 C.B. 109 11
91-52, 1991-2 C.B. 331 11
92-78, 1992-2 C.B. 143 11
93-59, 1993-2 C.B. 244 11

MISCELLANEOUS

129 Cong. Rec. (daily ed. Oct. 25, 1983) 23
Department of Justice Press Release, *Tax Attorney Received the John Marshall Award for Saving Tax Payers Five Billion Dollars* (June 22, 1995) .. 13, 30

TABLE OF AUTHORITIES—Continued

Page

Department of the Treasury, *Final Report to The Congress on Life Insurance Taxation* (Aug. 1989) 10, 12, 16, 22, 24, 25, 28
Department of the Treasury, *Interim Report to The Congress on Life Insurance Taxation* (June 1988) 12, 21, 28
H.R. Rep. No. 432, 98th Cong., 2d Sess. (1984) 4
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Tax Treatment of Life Insurance, Hearings Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means, 98th Cong., 1st Sess. (May 10, 11; July 28, 1983) 23

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PETITION FOR A WRIT OF CERTIORARI

American Mutual Life Insurance Company And Subsidiaries ("AMLI" or "Petitioner"), by its undersigned counsel, respectfully petitions for a writ of certiorari to review the judgment of the court of appeals in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-9a) is reported at 43 F.3d 1172. The opinion of the district court (App. 10a-17a) is reported at 1993 WL 556786; 73 A.F.T.R.2d (P-H) ¶ 94-301; and 93-2 U.S. Tax Cas. (CCH) ¶ 50,652.

JURISDICTION

The judgment of the court of appeals was entered on December 15, 1994. A petition for rehearing and suggestion for rehearing en banc was denied on March 21, 1995. App. 20a. On June 9, 1995, Justice Thomas entered an order extending the time within which to file a petition for a writ of certiorari to and including July 19, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

This petition concerns the interpretation of Section 809 of the Internal Revenue Code of 1986, 26 U.S.C. § 809. Certain other sections of the Internal Revenue Code, 26 U.S.C. §§ 801, 803, 804, 805, 807, 808, and a United States Department of the Treasury regulation, 26 C.F.R. § 1.809-9, also are relevant. These sections and regulation are set forth in the appendix. App. 21a-32a.

STATEMENT OF THE CASE

A. Factual Background

The facts in this case are not disputed. AMLI is a mutual life insurance company organized and existing under the laws of the State of Iowa. In 1986, AMLI paid a total of $13,985,737 in policyholder dividends. Because AMLI is a mutual life insurance company, it was required to perform the calculations in Section 809 to determine whether and to what extent its policyholder dividend deduction should be reduced. Following the procedure mandated by Section 809(a), AMLI calculated its "differential earnings amount" by applying the "differential earnings rate" of 10.539 percent (published by the Treasury Department) to its 1986 average equity base, resulting in a differential earnings amount of $9,826,925. In accordance with Section 809(a), AMLI then reduced its Section 808 *policyholder dividends deduction* for 1986 from $13,985,737 to $4,158,812.

For the next tax year, 1987, Section 809(f) required AMLI to calculate a "recomputed differential earnings amount" for 1986. That amount consisted of applying the "recomputed differential earnings rate" to AMLI's 1986 average equity base. In March 1988, when the Treasury Department published its tentative recomputed differential earnings rate for 1986, that rate was —1.700 percent. *See* Announcement 88-47, 1988-12 I.R.B. 56. Using this rate, as adjusted, AMLI calculated a recomputed differential earnings amount of —$1,580,476 for its 1987 in-

come tax return pursuant to Section 809(f).[1] Subtracting the recomputed differential earnings amount of —$1,580,476 from the initial differential earnings amount of $9,826,925, as mandated by Section 809(f)(2), produced a result of $11,407,401.[2] AMLI therefore claimed a Section 809(f)(2) *life insurance deduction* of $11,407,401 for the 1987 tax year.

As a result of the life insurance deduction so calculated, AMLI had an increased loss for the tax year 1987, which it then carried back to 1984 and claimed a refund. The IRS initially granted that refund. In 1991, however, AMLI was assessed with a corporate income tax deficiency, relating to the recomputed differential earnings amount claimed on the 1987 federal income tax return. AMLI paid the amounts assessed in full. After its administrative protests were rejected, AMLI filed this action, seeking a refund.

B. Section 809

This dispute has its origins in the 1984 effort by Congress to adjust the relative tax burdens of the stock and mutual segments of the life insurance industry. Stock companies essentially make two kinds of dividend distributions: dividends to their policyholders (viewed as price rebates) and dividends to their shareholders (viewed as earnings distributions). The former are deductible from federal taxes at the corporate level, and the latter are not. Mutual life insurance companies also pay policyholder dividends. Because they have no shareholders, however, they do not pay any shareholder dividends. In 1984, Congress believed that policyholder dividends distributed by mutual companies include a component that is akin to the earnings distributions that stock companies

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[1] The tentative —1.700 percent rate was calculated by using a tentative 1986 average mutual earnings rate of 17.985 percent. When the 1986 average mutual earnings rate was later determined to be 17.980 percent, the 1986 recomputed differential earnings rate became —1.695 percent, the rate used by AMLI in its federal income tax filings.

[2] $9,826,925 — (—$1,580,476) = $11,407,401.

make to their shareholders and that should be taxed at the corporate level. It therefore enacted a mechanism to estimate and tax the earnings portion of mutual companies' policyholder dividends.

The overall tax scheme into which this complex mechanism was inserted is fairly simple. Life insurance companies must pay taxes on life insurance gross income reduced by life insurance deductions. App. 21a (§ 801 (b)). Deductions include, among other things, "policyholder dividends" and "other deductions." App. 22a (§ 805(a)(3) & (8)). Both stock and mutual companies are allowed to deduct policyholder dividends. App. 23a-24a (§ 808). Mutual companies, however, must apply the formulae of Section 809, and, over time, this acts to impute additional income and thus increases their taxes to take account of the theoretical earnings portion of their policyholder dividends. App. 24a-31a (§ 808(c)(2); 809).

The mechanism chosen by Congress rests on the theory that over a period of years mutual and stock companies, being in the same industry, can be expected to have comparable earnings rates, and that therefore the earnings portion of a mutual company's policyholder dividends can be estimated by comparing the earnings of stock companies before shareholder dividends with the post-dividend earnings of mutual companies. The difference between the earnings rates (the differential rate) would, according to this view, approximate the rate of mutual company equity returns that are comparable to shareholder dividends. *See* H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 2, 1422 (1984), *reprinted in* 1984 U.S.C.C.A.N. 697, 1067; S. Rep. No. 169, 98th Cong., 2d Sess., Vol. I, 548-49 (1984).

In Section 809, Congress adopted a mathematical formula that imputes additional income to mutual companies based on a comparison of the current one-year average of mutual company earnings rates with an adjusted average of stock company earnings rates for the three previous years. This imputation of income, operating as it does on

the basis of industry averages, divorces the tax liability of a mutual company from the amount of policyholder dividends paid in any given year. The formula operates in two stages: In the first year, mutual companies calculate a differential earnings amount and, in the second year, they calculate a recomputed differential earnings amount. The differential earnings amount is computed by multiplying the "life insurance company's average equity base for the taxable year" by the differential earnings rate for that year. App. 25a (§ 809(a)(3)). Because, for any given tax year, the current mutual earnings rate is not available at the time the year's returns must be filed, the differential earnings rate (DER) is computed by using the average mutual earnings rate for the second preceding year. For 1986, the DER is calculated as follows:

1986 DER = 1986 Imputed Earnings Rate − 1984 Average Mutual Earnings Rate.[3]

App. 27a (§ 809(c)(1)). The 1986 imputed earnings rate, in turn, is an adjusted average of the stock earnings rates for 1983, 1984, and 1985.[4] App. 28a (§ 809(d)). The recomputed differential earnings amount is calculated the same way, except it uses mutual data from 1986. For 1986, the recomputed differential earnings rate is calculated as follows:

Recomputed 1986 DER = 1986 Imputed Earnings Rate − 1986 Average Mutual Earnings Rate.

Although the theory behind estimating and taxing the earnings portion of mutual companies' policyholder dividends rested on a year-by-year comparison of data, the mechanism enacted by Congress does not in fact com-

[3] The "average mutual earnings rate" is the aggregate gain or loss from operations for that year of all mutual life insurance companies divided by the aggregate average equity bases for that year of all mutual life insurance companies. App. 30a (§ 809(e)).

[4] The stock earnings rate for a year is the numerical average of the earnings rates of the 50 largest stock life insurance companies for that year. App. 29a (§ 809(d)(4)). Under Section 809(d)(1), the imputed earnings rate for any year is a specified fraction (namely .9055) of the average of the stock earnings rates for the three prior years.

pare earnings rates from the same year. Both the initial and the recomputed differential earnings rates rely on comparisons of a one-year industry average on the mutual side with a three-year industry average on the stock side. Neither the differential earnings amount nor the recomputed differential earnings amount for a given year takes into account, even as part of the three-year average, the stock companies' earnings rate for that year. Therefore, there is no necessary relation between the differential earnings rate calculated under the statute and the actual difference in the earnings rates for any given year. Instead, as the following discussion shows, the statute, if allowed to work over time, will reach a consistent result by averaging.

By choosing a mechanism that compares average earnings rates over several years, Congress took a multi-year view of equalizing the taxation burdens of the mutual and stock segments of the life insurance industry. In this multi-year view, it is essential that all values be considered, including any negative values. Otherwise, the result is irrational and statistically invalid.

Because earnings rates of insurance companies vary significantly from year to year, the mutual earnings rates for one year will occasionally be higher than the adjusted average of stock earnings rates for three prior years, even when stock company rates are consistently higher in a year-to-year comparison with mutual company rates. Consider, for example, the following three charts showing hypothetical rates of return for stock and mutual companies.[5] The first assumes stable rates for both segments for all years. In that example, the recomputed differential earnings rate, not surprisingly, remains stable, and the average recomputed DER is, as expected, identical to the recomputed DER (RDER) for each individual year.

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[5] To simplify the illustrations, we have not adjusted the average stock earnings rates by the 0.9055 percentage derived from Section 809(d)(1).

Example 1—Stable Rates

	1981-1983	1984	1985	1986	1987	1988	1989	Average Outcome 1986-89
A. Stk. earn. rate	16.5	16.5	16.5	16.5	16.5	16.5	16.5	
B. 3-year avg. stk. earn. rates		16.5	16.5	16.5	16.5	16.5	16.5	
C. Avg. mut. earn. rate		13.5	13.5	13.5	13.5	13.5	13.5	
D. RDER (B minus C)		3.0	3.0	3.0	3.0	3.0	3.0	3.0

In the second example, the rates remain the same except there is a six percent *decrease* in both the mutual and the stock companies' earnings rates in 1986. As one would expect given the tandem movement in both stock and mutual companies' earnings rates, the *average* recomputed differential earnings rate remains unchanged. But in reaching that average, the recomputed differential earnings rate for 1986 is artificially high. The government and AMLI agree that, under Section 809, the tax liability of mutual companies in 1986 will reflect this artificially high result, just as it will also reflect the lower recomputed DERs in the three succeeding years.

Example 2—6 percent decrease in rates in 1986

	1981-1983	1984	1985	1986	1987	1988	1989	Average Outcome 1986-89
A. Stk. earn. rate	16.5	16.5	16.5	10.5	16.5	16.5	16.5	
B. 3-year avg. stk. earn. rates		16.5	16.5	16.5	14.5	14.5	14.5	
C. Avg. mut. earn. rate		13.5	13.5	7.5	13.5	13.5	13.5	
D. RDER (B minus C)		3.0	3.0	9.0	1.0	1.0	1.0	3.0

In the final example, the rates remain the same except there is a six percent *increase* in both the mutual and the stock companies' earnings rates in 1986. Again, if

there are no artificial limits set, the average recomputed differential earnings rate remains the same as in the first two examples, which should be expected because the rates for the two segments are moving in tandem. The government, however, having reversed course during this litigation, now insists that a negative recomputed DER cannot exist and that any number that is calculated as negative must be replaced with a zero. Because this third chart illustrates the point at issue in this case, it contains two lines for the recomputed DER: D_1 showing the result urged by AMLI, and D_2 showing the result urged by the government. The result of the government's calculation is that, over time, the mutual insurance companies pay taxes based on a significantly higher average recomputed differential earnings rate (3.75 percent versus 3.0 percent) than was either provided for in Section 809 or contemplated by Congress. This is precisely the distortion that AMLI seeks to avoid.

Example 3—6 percent increase in rates in 1986

	1981-1983	1984	1985	1986	1987	1988	1989	Average Outcome 1986-89
A. Stk. earn. rate	16.5	16.5	16.5	22.5	16.5	16.5	16.5	
B. 3-year avg. stk. earn. rates		16.5	16.5	16.5	18.5	18.5	18.5	
C. Avg. mut. earn. rate		13.5	13.5	19.5	13.5	13.5	13.5	
D_1. RDER per AMLI (B minus C)		3.0	3.0	−3.0	5.0	5.0	5.0	3.0
D_2. RDER per gov't		3.0	3.0	-0-	5.0	5.0	5.0	3.75

The skewing of the averages that results when negative values are not considered should hardly be surprising. Any investment fund, for example, would want to omit any years in which it had a negative earnings rate in calculating its average historical earnings rate. Unfortunately, that is not the real world. Any averaging of this kind must consider the negative values along with

the positive values for there to be any statistically-valid meaning to the exercise.

The government's only proposed justification for ignoring negative values is the assertion that Section 809's formulae must be limited by the amount of policyholder dividends paid in any particular year. Section 809's language, however, contains no such artificial limits. The required calculations simply are not tied to the amount of policyholder dividends paid in any given year. Section 809(a) provides in relevant part:

> (1) POLICYHOLDER DIVIDENDS.—In the case of any mutual life insurance company, the amount of the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount.
>
> (2) REDUCTION IN RESERVE DEDUCTION IN CERTAIN CASES.—In the case of any mutual life insurance company, if the differential earnings amount exceeds the amount allowable as a deduction under section 808 for the taxable year (determined without regard to this section), such excess shall be taken into account under subsections (a) and (b) of section 807.

App. 24a (§ 809(a)(1) & (2)). In the first year, therefore, the amount of the policyholder dividend deduction is reduced by the differential earnings amount, but to the extent that the differential earnings amount is greater than the amount of policyholder dividends distributed by the company that year, the company's reserves are decreased, creating a dollar-for-dollar increase in the mutual company's gross income. *See* App. 24a; 23a (§ 809 (a)(2); § 807(a) & (b)). In other words, a mutual company must pay taxes on the full differential earnings amount calculated under Section 809, whether that amount is greater than the policyholder dividends paid by the company that year or not. Indeed, even if a mutual company paid no dividends in a year, it would still have to pay additional taxes under Section 809's imputation of income formulae.

Thus, Section 809's mechanism in the first step of the process clearly is independent of the amount of policyholder dividends paid by mutual companies. The Department of the Treasury acknowledged this point in its Final Report to Congress: "The imputation of equity income [in Section 809] was described as a limitation on policyholder dividend deductions, but in fact it is an income imputation. If the imputed income exceeds current policyholder dividends, the current reserve deduction is reduced by the excess." Department of the Treasury, *Final Report to The Congress on Life Insurance Taxation* 25 n.8 (Aug. 1989).

In the following year, Section 809 directs mutual life insurance companies to adjust their taxable income by the recomputed differential earnings amount. Section 809(f) provides in relevant part:

> (1) INCLUSION IN INCOME WHERE RECOMPUTED AMOUNT GREATER.—In the case of any mutual life insurance company, if—
>
> (A) the recomputed differential earnings amount for any taxable year, exceeds
>
> (B) the differential earnings amount determined under this section for such taxable year,
>
> such excess shall be included in life insurance gross income for the succeeding taxable year.
>
> (2) DEDUCTION WHERE RECOMPUTED AMOUNT SMALLER.—In the case of any mutual life insurance company, if—
>
> (A) the differential earnings amount determined under this section for any taxable year, exceeds
>
> (B) the recomputed differential earnings amount for such taxable year,
>
> such excess shall be allowed as a life insurance deduction for the succeeding taxable year.

App. 30a-31a (§ 809(f)(1) & (2)). Therefore, if the recomputed differential earnings amount is greater than

the first year's differential earnings amount, then the company must add the difference to its taxable income in that following year. App. 30a (§ 809(f)(1)). Because there is no limit to this part of the provision, the statute contemplates that the total amount added to a mutual company's income as a result of this section could easily exceed the amount of policyholder dividends paid by the company in the previous year. Therefore, like the first year's differential earnings amount, the recomputed amount is independent of the amount a company pays in policyholder dividends. Conversely, if the first year's differential earnings amount is greater than the recomputed amount, then the statute directs the company to take "such excess" as "a life insurance deduction" for that second year. App. 31a (§ 809(f)(2)). Once again, the section does not limit the operation of this provision to the amount of policyholder dividends paid by a company in any given year.

Petitioner's view that the statistically-valid reading of the statute must be the one intended by Congress finds support not only in logic but also in the government's own pre-litigation conduct. In implementing Section 809, the government, until it lost this case in the district court, agreed with AMLI that the intent of Congress was that the recomputed differential earnings rate could be negative. *See* App. 14a. Indeed, the government actually published the tentative recomputed differential earnings rate for 1986 as —1.700 percent. *See* Announcement 88-47, 1988-12 I.R.B. 56.[6] Furthermore, in its Reports to Congress, the Treasury Department never asserted that the word "excess" in the statute meant that the number had to be positive. Instead, it simply referred to the "difference between the differential earnings

[6] Even after the IRS announced that the recomputed differential earnings ratio could never be negative, it continued to publicly state that it had calculated other negative rates under Section 809. *See* Rev. Rul. 89-106, 1989-2 C.B. 109; Rev. Rul. 91-52, 1991-2 C.B. 331; Rev. Rul. 92-78, 1992-2 C.B. 143; Rev. Rul. 93-59, 1993-2 C.B. 244.

amount and the recomputed differential earnings amount." Department of the Treasury, *Interim Report to The Congress on Life Insurance Taxation* 5 (June 1988); *Final Report*, *supra*, at 8; *see also* S. Rep. No. 169, 98th Cong., 2d Sess., Vol. I, 552 (1984) (stating that statute will take account of "any difference" between the two differential earnings amounts). The Treasury Department also admitted that Section 809 was intended to operate over more than just one year. *See Interim Report, supra*, at 15 n.2 ("Tax liability generated from life insurance activity may affect tax payments in future years."). Reflecting the statute's multi-year approach, the Treasury Department declared that "Congress also believed that mutual and stock companies in the same industry will earn comparable rates of return on equity *over a period of several years.*" *Final Report, supra*, at 26 (emphasis added). These consistent and early pronouncements were in keeping with the language and legislative intent of Section 809 and with the interpretation of the statute that AMLI urges, and they culminated in the government's concession in the district court in this very case that the recomputed differential earnings rate could be negative.

C. Procedural History

AMLI filed this lawsuit on September 27, 1991, in the United States District Court for the Southern District of Iowa. The district court accepted the government's concession that the recomputed differential earnings rate could be negative, concluded that the life insurance deduction authorized by Section 809(f)(2) is not restricted by Section 808 of the Code, and accordingly ruled that AMLI was entitled to the full life insurance deduction claimed and therefore to the requested refund. App. 16a-17a.

The government appealed and withdrew its concession that the recomputed differential earnings rate could be negative. The government stated that that concession was inconsistent with the Treasury Department's revised interpretation of the statute (made only after losing the

case in the district court). Central to the government's argument was the assertion that in no event could the total deduction for a particular year (*i.e.*, the first-year policyholder dividend deduction plus the second-year life insurance deduction) be greater than the amount of policyholder dividends paid in that year. Therefore, according to the government, the recomputed differential earnings rate could never be negative. The court of appeals accepted the government's argument and reversed the decision of the district court. App. 7a. As the first sentence of the opinion demonstrates, the court's entire reasoning was based on the acceptance of the notion that the deductions permitted by Section 809 for any one year could never be greater than the amount of policyholder dividends paid in that year. App. 1a-2a. At no point did the court explain how or why this limitation was inserted into Section 809.

REASONS FOR GRANTING THE PETITION

This case presents an issue of exceptional importance concerning the proper interpretation and administration of the federal income tax laws. The court of appeals read out of Section 809 an essential part of the mathematical formula contained in that section. By doing so, the court significantly increased the tax liabilities of mutual companies contrary to the plain meaning of the section and the legislative intent behind the section. The court also departed from the basic tenets of statutory interpretation.

Moreover, as the Department of Justice itself acknowledged in a press release touting its victory in the court of appeals, the legal issue presented in this case involves tax consequences of 5 *billion* dollars for the mutual life insurance industry. *See* Department of Justice Press Release, *Tax Attorney Received the John Marshall Award for Saving Tax Payers Five Billion Dollars* (June 22, 1995). That money would come from the more than 100 million mutual life insurance policyholders and beneficiaries in this country. Further, if the court of appeals' decision is allowed to stand, mutual life insurance com-

panies will be disadvantaged tremendously with respect to maintaining their already diminishing market share as against stock life insurance companies. Such a result would directly contradict the congressional intent of enacting a taxing mechanism that would level the playing field and not favor one segment of the industry over the other.

Finally, this case provides an ideal occasion for the Court to resolve this important issue. The record is complete and there are no factual disputes. The question was fully briefed and argued by the government and AMLI both in the district court and in the court of appeals. The statutory interpretation question is squarely presented. If this Court does not act now on this issue, a significant number of smaller mutual companies, whose audits have been completed for the tax years at issue, will need to initiate litigation in various federal courts to prevent the statute of limitations from running on their substantial claims. Neither this Court nor the federal judicial system nor the mutual companies would derive any benefit from postponing review until more and more cases are litigated in the lower federal courts.

For all of these reasons, which are explained more fully below, the Court should grant review and correct the court of appeals' misinterpretation of Section 809.

I. THE COURT OF APPEALS IMPROPERLY APPLIED RULES OF STATUTORY INTERPRETATION AND IGNORED THE CLEAR LANGUAGE OF THE STATUTE AS WELL AS THE RECORD IN CONSTRUING SECTION 809 AS IT DID.

This case involves solely a question of statutory interpretation. There is no dispute that AMLI used the formulae in Section 809 to calculate its differential earnings amount and its recomputed differential earnings amount. The dispute centers on whether Section 809 allows for a negative recomputed differential earnings rate and therefore a negative recomputed differential earn-

ings amount. Petitioner contends that it does, and the court of appeals ruled that it does not.

The holding of the court of appeals is remarkable in its "blinders" approach to AMLI's position. The court did not disagree with AMLI that refusal to consider negative recomputed differential earnings rates would skew the results of the formulae over time. The court did not provide a statistical or rational reason why Congress would have required mutual companies to ignore the negative recomputed differential earnings rates. And the court did not deny that its ruling would treat mutual companies less favorably than stock companies, in contradiction to the stated congressional intent.

The court of appeals reached its erroneous result by accepting the government's invitation to subordinate Section 809 to Section 808, by disregarding the nature of the new taxation scheme that Congress enacted in 1984, and by accepting the simplistic but distorting notion that the two separate deductions authorized by Section 809 on successive returns could not be allowed under any circumstances to exceed the amount of dividends actually paid during the year in question.[7] From the court's very statement of the issue in the first paragraph of its opinion, it was off on the wrong track, incorrectly announcing, with the encouragement of the government, that the issue is "whether Congress intended to give mutual life insurance companies so-called dividend deductions greater than their dividends in any given year." App. 1a-2a. By thus emphasizing Section 808, which provides for the deduction of policyholder dividends on a year-by-year basis, the court demoted both the statutory language of Section

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[7] The court of appeals' shallowness of analysis is further revealed by its mischaracterization of AMLI's position, and by the syllogism that the Court then used to dismiss that misstated position: The heading of Section 809 refers to a *reduction* in a company's deduction; "AMLI's position is that it is entitled to a deduction *enhancement*"; therefore, AMLI's position must be incorrect. App. 5a. At each step of this syllogism, however, the court's logic is faulty as we further demonstrate below.

809, which provides multi-year formulae that are independent of Section 808, and the legislative intent underlying that provision.

A. The Court Of Appeals Mistakenly Relied On The Heading Of Section 809 In Interpreting The Otherwise Plain Language Of Section 809.

This Court recently looked to the "plain language" of a section of the Internal Revenue Code as the most important guide to interpreting that section. *See Commissioner v. Schleier,* —— U.S. ——, 115 S. Ct. 2159, 2167 (1995). Here by contrast, the court of appeals discounted the plain language of Section 809, as well as the only statistically valid method for the statute's formulae to operate, and instead relied largely on the statute's heading. This was error.

In the court of appeals' view, the heading of Section 809—"Reduction in certain deductions of mutual life insurance companies"—requires that the total deductions authorized by the section for any given year be limited by the amount of policyholder dividends paid in that year. The heading itself is not so rigid; it refers only to a "reduction in *certain* deductions." Moreover, the Treasury Department has already admitted that the heading of Section 809 does not accurately reflect the actual text of the section and that the statutory mechanism enacted by Congress is not limited by the amount of dividends paid.

> The imputation of equity income [in Section 809] was described as a limitation on policyholder dividend deductions, but in fact it is an income imputation. If the imputed income exceeds current policyholder dividends, the current reserve deduction is reduced by the excess.

Final Report, supra, at 25 n.8. The Treasury Department's admission is compelled by the language of the statute, and it eviscerates the court of appeals' reliance on the heading as a guide to interpretation.

In any event, a heading of a section "is but a shorthand reference to the general subject matter involved."

Brotherhood of Railroad Trainmen v. Baltimore & O.R.R., 331 U.S. 519, 528 (1947). This Court has explicitly held that

> headings and titles are not meant to take the place of the detailed provisions of the text. . . . [*T*]*he heading of a section cannot limit the plain meaning of the text.* . . . For interpretative purposes, they are of use only when they shed light on some ambiguous word or phrase. They are but tools available for the resolution of a doubt. But they cannot undo or limit that which the text makes plain.

Id. (emphasis added) (citations omitted); *see United States v. Minker*, 350 U.S. 179, 185 (1956); *Maguire v. Commissioner*, 313 U.S. 1, 9 (1941). As demonstrated below, the mathematical formulae enacted in Section 809 are unambiguous and the court of appeals' reliance on the heading to "limit that which the text makes plain" is incorrect.

As outlined above, Section 809 requires mutual companies to calculate two different numbers in two different years: the differential earnings amount, which can affect a mutual company's policyholder dividends deduction *and* reserves in the first year, and the recomputed differential earnings amount, which can affect a mutual company's gross income *or* life insurance deduction in the second year. As is evident from even this short summary of these calculations, the court of appeals' position that these calculations relate solely to the amount of policyholder dividends that a mutual company paid in a particular year is simply untenable. Contrary to the court's holding, the statutory language requires that these two calculations not be limited to the amount of policyholder dividends paid—either on the high or low end. Indeed, even if a mutual company pays no policyholder dividends in a particular year, Section 809 can require it to impute additional income and pay an increased tax.

Section 809 clearly provides that both the differential earnings amount and the recomputed differential earnings

amount are independent of the policyholder dividends paid in any given year. The statutory formula imposes a potentially unlimited tax liability on mutual companies. The calculation in the first year provides that "the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount." App. 24a (§ 809(a)(1)). Only to the extent that Congress specifically provided that the (a)(1) deduction cannot go "below zero" is the operation of this calculation tied to the amount of policyholder dividends paid in any given year. But even then, the section requires that when the differential earnings amount is greater than the amount of policyholder dividends paid by the company that year (which would give a result below zero), the company's reserves are decreased, creating a dollar-for-dollar increase in a mutual company's taxable income. *See* App. 25a; 23a (§ 809(a)(2); § 807(a) & (b)). The calculation of the differential earnings amount is therefore not tied or limited to the amount of the policyholder dividends deduction allowed under Section 808.

The calculation in the second year, the recomputed differential earnings amount, is also independent of the amount of policyholder dividends paid in any given year. Section 809(f) provides a mechanism in which mutual life insurance companies must recompute the differential earnings amount that was included in the previous year's tax.

If, on the one hand, it turns out that the recomputed amount is greater than the original amount, Section 809(f)(1) requires the company to include the excess as "life insurance gross income" for that year, to the tax detriment of the company. It does not matter how much greater the recomputed amount may be; even if the difference is more than the total policyholder dividends paid the previous year, the statute directs that "such excess *shall* be included in life insurance gross income for the succeeding taxable year." App. 30a (§ 809(f)(1)) (emphasis added). Section 809(f)(1) thus imposes a potentially unlimited tax liability on mutual companies.

If, on the other hand, it turns out that the recomputed amount is less than the original amount, then the company is allowed to deduct the difference from that year's taxable income as a "life insurance deduction." *See* App. 30a-31a (§ 809(f)(1) & (2)). Nothing in Section 809(f) limits that deduction or refers to any other provision imposing any such limit.

Nonetheless, the court of appeals ruled that the statute somehow restricts this life insurance deduction to an amount that, when added to the previous year's policyholder dividend deduction, does not exceed the dividends actually paid in that year. To reach this result, however, the court in effect added to Section 809(f)(2) a concluding phrase that does not appear in the statute, namely, "to the extent the sum of the two deductions is not greater than the total amount of policyholder dividends paid the previous year." Changing the meaning of the section in such a drastic and significant way cannot be supported. *See Crooks v. Harrelson*, 282 U.S. 55, 58 (1930) ("to construe the clause as though it said, 'to the payment of charges and expenses, *or either of them*,' as petitioner seems to contend, would be to add a material element to the requirement, and thereby to create, not to expound, a provision of law") (emphasis in original); *United States v. Temple*, 105 U.S. 97, 99 (1882) ("When the language is plain we have no right to insert words and phrases, so as to incorporate in the statute a new and distinct provision.").

Yet that is precisely what the Treasury Department did when it issued regulations after losing this case in the district court. It rewrote Section 809 to include a provision prohibiting the recomputed differential earnings rate from ever being "less than zero." App. 32a (26 C.F.R. § 1.809-9(a)). Such a provision is made up of whole cloth.

The court of appeals' interpretation of Section 809 limits the tax *benefits* of the mathematical formula on the ground that the section is inextricably linked to the amount of policyholder dividends paid in any given

year. Yet at the same time the court properly gives meaning to the Section 809 provisions that increase the tax *liabilities* of mutual companies, even though the language of those provisions unambiguously severs any relationship between Section 809's calculations and the amount of policyholder dividends paid in any given year. It simply makes no sense to read into Section 809 nonexistent language that creates a restrictive relationship between the amount of policyholder dividends paid and the mathematical formulae that estimate earnings in mutual companies, when language in Section 809 provides that such a relationship just does not exist. *See Moore v. United States*, 249 U.S. 487, 489 (1919) ("act of Congress must be read 'according to the natural and obvious import of the language, without resorting to subtle and forced construction for the purpose of either limiting or extending its operation' ") (quoting *United States v. Temple*, 105 U.S. 97, 99 (1882)).

B. The Court Of Appeals Mistakenly Relied On Section 808 In Interpreting The Otherwise Plain Language Of Section 809.

The other principal ground for the court of appeals' misinterpretation of Section 809 was that Section 808(c) provides for a reduction of the policyholder dividend deduction:

> (c) AMOUNT OF DEDUCTION.—
>
> (1) IN GENERAL.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.
>
> (2) REDUCTION IN CASE OF MUTUAL COMPANIES.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809.

App. 24a (§ 808(c)). Although the genesis of the statute at issue was Congress' "attempt to isolate the taxable

component of dividends that mutual life insurance companies like AMLI make to their policyholders," App. 2a, the mechanism enacted by Congress in Section 809 was one that was not tied to the amount of policyholder dividends paid in any particular year. In ascribing such overriding importance to Section 808, the court of appeals shoehorned the statute into a narrowly-defined time period. By focusing on a single given year, and ignoring the multi-year approach, the court of appeals misinterpreted Section 809. In light of the structure of the statute, the way the differential earnings rate is defined, and the legislative history, the only sensible interpretation of Section 809 is one that takes the multi-year view.

The structure of the statute confirms that Congress did not provide and did not intend that mutual life insurance companies pay a tax based on a single annual adjustment of the policyholder dividends deduction. Rather, the statute proceeds through a two-step calculation for each year, and each step in that process relies on an average of three prior years' stock earnings rates. The statute is designed to produce its intended result over time, not in a year-by-year snapshot. App. 24a, 30a (§ 809(a) & (f)); *see Interim Report, supra,* at 15 n.2. Although the court of appeals stated that the second year's calculation relates solely to the policyholder dividends paid in the first year, App. 4a, the statute itself differentiates between the two, calling the first-year calculation a policyholder dividend deduction reduction and the second-year calculation a life insurance deduction.

Further support for the proposition that the life insurance deduction taken in the second year is not limited by the amount of policyholder dividends paid, or the amount of the policyholder dividend deduction taken, in the first year is provided by the relevant IRS instructions and forms. According to the instructions to Form 1120L, the first-year "Deductible policyholder dividends," which include the Section 809(a) reduction in the policyholder dividend deduction, are calculated on Schedules E and F, and set forth on line 11 of Schedule A. In contrast, the

second-year "Other deductions," which include Section 809(f)(2) "life insurance deductions," are set forth on line 14 of Schedule A. *See* Form 1120L (1987).

Section 809's reliance on an adjusted three-year industry average of stock life insurance companies' earnings rates for years other than the year in question confirms the statute's intended time frame. App. 27a (§ 809(c)). The very definition of the key variable requires mutual companies to take into account a multi-year view of the relationship between stock company earnings and mutual company earnings to determine the purported earnings portion of mutual policyholder dividends.

The record in the district court contained uncontradicted evidence that limiting total deductions for each year to the amount of dividends paid in that year and preventing the use of a negative recomputed differential earnings rate does not make sense from a statistical point of view. Because the statutory formula compares rolling averages of earnings rates for three prior years for stock companies with the current year's earnings rate for mutual companies, there is no necessary correlation between the formula and the actual differences in earnings rates between mutual companies and stock companies for any given year. Because earnings rates vary from year to year, the use of this multi-year formula causes the rate to be skewed to an artifically high or low level (possibly including negative levels) for individual years. To measure fairly and accurately the difference between the rates, all values in the formula—including the negative values—must be included.

Finally, the legislative history of Section 809 confirms that its intent was to provide a multi-year picture of the earnings portion of any policyholder dividends paid by mutual companies. The Treasury Department's review of the legislative history confirms this: "Congress also believed that mutual and stock companies in the same industry will earn comparable rates of return on equity *over a period of several years.*" *Final Report*, *supra*, at 26. In addition, repeated throughout the legislative his-

tory was the congressional mantra to "level the playing field" between the stock companies and the mutual companies.[8] That playing field, however, cannot be level if it achieves inequitable results. The court of appeals' interpretation produces such inequitable results by limiting the calculation to the amount of policyholder dividends paid in any given year. Indeed, in its Final Report to Congress (which the Tax Reform Act of 1984 required), the Treasury Department acknowledged the inequities that inevitably result from the rule that the recomputed differential earnings rate can never be negative. As the Treasury Department recognized, these inequities only compound the already "inappropriate" mismatching of years involved in the statutory calculation.

> Furthermore, the mismatching is more likely to deny to mutual companies full credit for their earnings in a year in which both segments have unusually high earnings, and the high mutual earnings rate is compared with the lower stock rates of the preceding years. The Internal Revenue Service has ruled that the

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[8] *See* 129 Cong. Rec. S14529 (daily ed. Oct. 25, 1983) (stating purpose to "maintain intra-industry balance between stock and mutual companies") (Sen. Bentsen); *id.* at S14544 (stating goal to "strike a proper balance between the tax burdens on the two major segments of the industry") (Sen. Chafee); Staffs of the Joint Comm. on Taxation and Senate Comm. on Finance, *Major Issues in the Taxation of Life Insurance Products, Policyholders & Companies*, 10-11 (Joint Comm. Print 1983) ("Probably the most important point is that, whatever approach is taken on this issue, the goal is primarily to provide a mechanism for competitive balance between stock and mutual companies which will be dynamic enough to adjust to changes in the industry over time."); *Tax Treatment of Life Insurance, Hearings Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means*, 98th Cong., 1st Sess. 69 (May 10, 11; July 28, 1983) ("The question is how to retain the competitive balance between the stocks and mutuals and at the same time have a just, fair and equitable tax law.") (Rep. Guarini); *id.* at 76 (goal is "to level that playing field between stocks and mutuals") (Chairman Starks); *id.* at 221, 223 (goal is "to create a level playing field") (Rep. Moore); *id.* at 226, 379 (same) (Rep. Dorgan); *id.* at 229 (same) (Rep. Kennelly).

> average mutual earnings rate for any year cannot exceed the imputed stock earnings rate for that year. As a result, part of the mutual company earnings for a high earnings rate year may never be included in the formula of section 809. . . . In other words, a significant portion of mutual company earnings in 1986 will never be taken into account under section 809.

Final Report, supra, at 35 (footnote omitted). This is precisely the result ordered by the court of appeals at the urging of the government. To say that Congress intended such a result simply flies in the face of its expressly stated purpose of leveling the playing field. In another tax case, this Court ruled:

> What the Commissioner cannot do—because it is an "unreasonable" interpretation of the statutory language in light of its history and purpose—is to resolve the practical problems by eliminating the allowance altogether. Eliminating the allowance might make the statute "simpler to administer," . . . but it does so by ignoring the language of the statute, the views of those who sought its enactment, and the purpose they articulated.

Commissioner v. Engle, 464 U.S. 206, 227 (1984). The government here is trying to eliminate the negative values in the statutory formulae by ignoring the statutory language and the views of those who enacted it. This Court should not permit it to do so.

Moreover, the Treasury Department has also recognized that the underlying theory of Section 809, *i.e.*, that there is an untaxed earnings portion of a mutual company's policyholder dividends, was flawed from the outset, and that, as a result, Section 809 imposes an extra tax on mutual companies. *See Final Report, supra,* at 26-28, 36. Whereas investors in stock life insurance companies provide their companies with a tax-free capital base, a mutual company's policyholder premiums, which are used in the same manner as the stock companies' capital contributions from investors, are subject to a corporate tax imposed at the time those premiums are received. There-

fore, when mutual companies return portions of the premiums to their policyholders as dividends, they are returning money that has already been subject to a tax at the corporate level. Thus, the tax imposed by Section 809 is a double tax on mutual companies; one that is not being paid by stock companies. *Id.* at 26-28. Although the place to right this wrong is obviously in Congress, it is, to put it mildly, undesirable to exacerbate the inequity by interpreting Section 809 in a way that further disadvantages mutual companies.

To the extent that the court of appeals was trying to further the "purpose of the statute[, which] is to reduce mutual companies' deductions by imputing income into dividends that would otherwise be fully deductible," App. 5a, that purpose is served by the district court's and AMLI's reading of the statute. The only question is how much and over what period of time. A multi-year view of Section 809 does limit and reduce mutual companies' dividend deductions over time. Indeed, as the statistics demonstrate, over the first eleven years that the statute has been in effect, AMLI's and the mutual life insurance industry's deductions have been reduced by the operation of Section 809, even when a negative recomputed differential earnings rate is recognized. From 1984 through 1994, AMLI paid approximately $197 million in policyholder dividends. Under AMLI's interpretation of Section 809, AMLI is not allowed to deduct approximately $12.3 million of that amount.[9] In other words, even under AMLI's interpretation, Section 809 has acted as a *deduction reduction* mechanism over time.

Thus AMLI's interpretation of the statute is consistent with the statutory language and furthers not only the

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[9] The government has not yet published the recomputed differential earnings rate for 1994. The 1994 component of the above amount is therefore estimated using figures appearing in a Moody's Investors Service report. *See* Moody's Investors Service, *Moody's Sees Higher Taxes for Mutual Life Insurance Companies Affecting Capital Growth* (April 1995). Under the government's interpretation of Section 809, AMLI is not allowed to deduct approximately $40 million of the $197 million in dividends paid.

purpose stated by Congress (creating a level playing field), but even the purpose the government has sought to attribute to Congress (reducing the policyholder dividend deduction for mutual companies). In contrast, the government's interpretation does violence to the statutory language and ignores at least one purpose of the statute. Petitioner's interpretation is therefore the correct one. *See United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132, 143-44 (1989). By interpreting the statute consistent with AMLI's view, there are no "inappropriate" results, the Treasury is not looted, and the intent of Congress is followed. Although the court of appeals' interpretation increases revenue for the Treasury, that is not a principled basis for decision, especially when the result is accomplished by inequitable means and in derogation of the congressional intent underlying the statute.

C. The Court Of Appeals Misinterpreted Section 809's Use Of The Term "Excess."

The court of appeals ruled that "[n]either the recomputed differential earnings rate nor the recomputed differential earnings amount should be negative." App. 7a. In attempting to support this decision, the court reasoned that "Congress . . . assumed that the imputed earnings rate (based upon stock company data) would always exceed the average mutual earnings rate. . . . But whether Congress was right or wrong in its assumption, it expected, and thus intended, that 'excess' would be a positive number." *Id.* In addition, the court stated that the "term excess . . . is more susceptible to a reading as a positive number than as a negative number." *Id.* Both these premises are fundamentally unsound.

First, Congress did not assume that the imputed earnings rate would always exceed the average mutual earnings rate. Instead, it assumed only that *for a given year* the stock companies' earnings rate would exceed the mutual companies' rate. Because the *imputed* earnings rate involves an average of the three previous years of stock company earnings, this congressional assumption, which had support in the statistical data presented to

Congress, can remain valid even accepting AMLI's interpretation of the statute. Therefore, to the extent that the court below believed that the improperly stated assumption mandated the government's interpretation of the statute, it was simply wrong. Moreover, the court of appeals' decision prevents the statute from operating to reduce mutual company tax burdens for years in which prior years' stock company earnings rates are in fact less than the mutual rate for the current year. Such a decision reads into the statute a goal of disadvantaging mutual companies, instead of leveling the playing field.

As to the second rationale given, the use of the term "excess" in various other subsections of Section 809, supports the position that the use of "excess" in subsection (c) allows it to refer to negative numbers. When Congress, in the 1984 legislation, intended the term "excess" to refer only to positive numbers, it specifically provided for the treatment of positive and negative results. For example, subsection 809(a)(1) directs that "the amount of the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount." App. 24a. Subsection 809(a)(2) then provides that "if the differential earnings amount exceeds the amount allowable as a deduction under section 808 . . ., such *excess* shall be taken into account under subsections (a) and (b) of section 807." App. 24a-25a (emphasis added). "Excess" must be positive there, because subsection 809(a)(1) directs what must be done if there is a negative excess. Again in subsections (f)(1) and (f)(2) of Section 809, Congress used the term "excess", but provided specific instructions as to what is to happen when the number is positive or negative.

In contrast, the subsections that define the recomputed differential earnings rate state that it is "the excess of—(A) the imputed earnings rate for the taxable year, over (B) the average mutual earnings rate" for that year. App. 27a (§ 809(c)(1) & (f)(3)). There are no other definitions of what the rate can be or what happens in various

circumstances. Therefore, the term "excess" as used in this context certainly could refer to both positive and negative results. *See, e.g., Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932) (a word can have different meanings even when used within the same section of a statute).

Moreover, the record is decidedly one-sided for the view that the recomputed DER can be negative. All the experts, including the one hired and paid for by the government, agreed that the rate as written in Section 809 could be negative. Indeed, even the government at the district court level admitted that the calculations in Section 809 could produce negative differential earnings rates. On appeal, the government withdrew its earlier admission and suggested that inexperienced counsel were to blame. The government's position, however, was not the result of a mistake by counsel. Instead, it was the practice and policy of the Treasury Department since the passage of the 1984 statute to read Section 809 as being able to generate negative recomputed differential earnings rates.

Indeed, the Treasury Department admitted that the differential earnings rate and the recomputed differential earnings rate could be negative and actually published the tentative recomputed differential earnings rate for 1986 as —1.700 percent. *See* Announcement 88-47, 1988-12 I.R.B. 56. In its Reports to the Congress, it failed to assert that the word "excess" in the statute meant that the number had to be positive. Instead, it discussed the excess as the "difference between the differential earnings amount and the recomputed differential earnings amount." *Interim Report, supra*, at 5; *Final Report, supra*, at 8. Such use was consistent with the legislative history of the statute, which stated that "when actual data becomes available, any difference beween the average differential earnings amount for the taxable year and the average differential earnings amount for the second preceding year is to be taken into account as an addition to or deduction from income . . . ." S. Rep. No. 169, 98th Cong., 2d Sess.,

Vol. I, 552 (1984). Moreover, even after the Internal Revenue Service announced that the recomputed differential earnings rate could never be negative, it continued to announce that it had calculated other negative rates under Section 809. *See* note 6 *supra*.

Petitioner's position that "excess" can be negative in Section 809, therefore, is not a taxpayer's strained attempt to capitalize on some loophole in the Internal Revenue Code. Instead, that reading was the interpretation of the Department of the Treasury until it decided that such an interpretation was detrimental to its litigating position in this lawsuit. The government's argument, accepted by the court of appeals, that the recomputed differential earnings rate can never be negative therefore must be taken with some salt. Nothing in the language of Section 809 requires this result.

II. THE PETITION SHOULD BE GRANTED BECAUSE IT WILL SAVE JUDICIAL RESOURCES TO RESOLVE THE ISSUE NOW.

In the court below, the government recognized the immense importance of this issue, requesting extensions of time and expanded page limits due to the question's significance. *See* Declaration of Edward T. Perelmuter, ¶ 2 (June 24, 1994) (filed in support of Appellant's Motion to Exceed Page Limits); Unopposed Motion for Extension of Time for Filing Appellant's Reply Brief, ¶ 1 (June 24, 1994). Because of the issue's overriding importance to the administration of the federal tax laws, review is warranted on that ground alone. *See, e.g., United States v. Goodyear Tire & Rubber Co.*, 493 U.S. 132, 138 (1989) (granting certiorari to "clarify the operation of the § 902 credit in the tax years to which it applies"); *Harrison v. Northern Trust Co.*, 317 U.S. 476, 478 (1943) (granting certiorari "because of the importance of the question in the administration of the federal estate tax system").

In addition, this case is of extreme importance due to the staggering amount of money involved. The government itself estimates that the ruling it won in the court of

appeals will cost the mutual life insurance industry 5 *billion* dollars. *See* Department of Justice Press Release, *Tax Attorney Received the John Marshall Award for Saving Tax Payers Five Billion Dollars* (June 22, 1995). For that reason alone, this Court should grant certiorari. *See, e.g., United States v. Hill*, —— U.S. ——, 113 S. Ct. 941, 945 (1993) ("Because of the importance of the issue to the federal fisc, we granted certiorari."). This ruling will also adversely affect the more than 100 million mutual policyholders and beneficiaries.

Moreover, this is not an issue that will await some sort of legislative correction. Although large insurance companies are able to keep their tax returns open for many years while all issues are resolved, smaller companies, like AMLI, must close their returns. Therefore, many companies have closed or are closing their books with regard to the 1986 tax year and the years thereafter. To prevent the statute of limitations from running, these smaller companies will need to file lawsuits against the United States to preserve this issue. As a result, the federal courts will face numerous lawsuits, all involving this one issue of statutory interpretation. Because the stakes are so high, this issue can be expected to be litigated by mutual insurance companies in many, if not all federal circuits. The court of appeals' decision will be binding only in the Eighth Circuit. The lawsuits will not end until this Court has definitively ruled.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

PETER BUSCEMI *
MARK A. SRERE
MORGAN, LEWIS & BOCKIUS
1800 M Street, N.W.
Washington, D.C. 20036
(202) 467-7190
Counsel for Petitioner

July 19, 1995

* Counsel of Record

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
EIGHTH CIRCUIT

No. 94-1440

AMERICAN MUTUAL LIFE INSURANCE COMPANY and SUBSIDIARIES,
Appellee,

v.

UNITED STATES OF AMERICA,
Appellant,

THE STOCK COMPANY INFORMATION GROUP,
Amicus Curiae.

Submitted Oct. 10, 1994

Decided Dec. 15, 1994

Rehearing and Suggestion for Rehearing En Banc
Denied March 21, 1995 *

Before MAGILL, Circuit Judge, HEANEY, Senior Circuit Judge, and MORRIS SHEPPARD ARNOLD, Circuit Judge.

MORRIS SHEPPARD ARNOLD, Circuit Judge.

The issue in this case is whether Congress intended to give mutual life insurance companies so-called dividend

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* Hansen, Circuit Judge, took no part in the consideration or decision of this case.

deductions greater than their dividends in any given year. The court concludes that Congress did not so intend, and therefore reverses the judgment of the district court.

I.

Appellee American Mutual Life Insurance ("AMLI") is a mutual life insurance company. AMLI sued the government for a tax refund, claiming that the Internal Revenue Service improperly calculated its income deductions for the year 1986. The district court granted summary judgment to AMLI, concluding that the statute allowed AMLI the full amount of the deductions it claimed. The government has appealed, asserting that the district court's reading of 26 U.S.C. § 809 violates congressional intent.

Section 809 is an attempt to isolate the taxable component of dividends that mutual life insurance companies like AMLI make to their policyholders. Mutual life insurance companies make dividends to their policyholders that contain both taxable and untaxable components. The taxable component is the distribution of earnings to owners; the untaxable component consists of price rebates to customers. The dividend that mutual life insurance policyholders receive is not easily broken into its components because mutual life insurance companies do not have separate groups of stockholder owners and policy-holding customers. The customers own the company. By contrast, stock life insurance companies pay earnings to stockholders as nondeductible dividends, and refunds to their insurance policyholders as deductible price rebates.

Section 809 is thus designed to identify the taxable component of mutual life insurance company dividends. It imputes income to mutual life insurance companies based on actual rates of return on equity experienced by stock companies, and requires mutual life insurance com-

panies to reduce their deductions to reflect an imputed distribution of earnings to their policyholders.

Section 809 requires a comparison between an imputed stock company rate of return before the payment of stockholder dividends (the "imputed earnings rate"), and a mutual company rate of return after the payment of policyholder dividends (the "average mutual earnings rate"). Section 809(c)(1), (d), (e). The mutual company rate of return is based on two-year-old data. Congress theorized that the difference between these two rates was attributable to equity returns distributed to mutual company policyholders and that the difference provided a basis on which to adjust the income of mutual life insurance companies. The excess of the imputed earnings rate over the average mutual earnings rate produces a "differential earnings rate" which is multiplied times the individual company's average equity base for the year to produce a "differential earnings amount." Section 809(a)(3), (b)(1), (c)(1). This amount represents the earnings component of the mutual company's dividend. The mutual company then reduces its policyholder dividends deduction by the differential earnings amount. Sections 808(c)(2), 809(a)(1).

Second 809 is quite complex, not only because it relies upon numerous calculations, but because it relies in part on an average of the earnings rate of mutual companies for the taxable year, a figure that is not available until a year after that the tax is due. As a result, section 809 requires two computations in each of two tax years: the first is made the year the tax is due, and the second is made the following year. The first makes a preliminary calculation of the deduction based on average mutual company earnings data from two years before. *See supra.* In the second calculation, a "recomputed differential earnings rate" and a "recomputed differential earnings amount" are calculated based on the difference between the imputed earnings rate for the prior year and the average

mutual earnings rate for the prior year. Section 809(c)(1), (f)(3). If the differential earnings amount exceeds the recomputed differential earnings amount, the excess is allowed as a "life insurance deduction" in the following year. Section 809(f)(2).

We stress that the recalculation is merely a means of achieving a result that was not possible to calculate in the tax year. The first calculation represents the method by which Congress intended to tax mutual life insurance companies; the second calculation is merely a housekeeping measure to reflect the updated data.

II.

The tax year in question is 1986. On its federal income tax return for 1986, AMLI reported a 1986 differential earnings amount of $9,826,925. AMLI arrived at this figure by multiplying the 1986 differential earnings rate of 10.539 percent by plaintiff's 1986 average equity base of $93,243,430. The 1986 differential earnings rate was reckoned as the difference between the 1986 imputed earnings rate (16.285%) and the 1984 average mutual earnings rate (5.746%). Pursuant to sections 808(c)(2) and 809(a)(1), AMLI reduced its policyholder dividends deduction for 1986 by the differential earnings amount, from $13,985,737 to $4,158,812. These figures are not in dispute.

The following figures are in dispute. For the subsequent tax year, 1987, AMLI claims a 1986 recomputed differential earnings amount of *minus* $1,580,476. AMLI arrived at this figure by multiplying the 1986 "recomputed differential earnings rate" of —1.695% by AMLI's 1986 average equity base of $93,243,430. AMLI calculated the 1986 recomputed differential earnings rate as the 1986 imputed earnings rate (16.285%) minus the 1986 average mutual earnings rate (17.980%). AMLI therefore claims a life insurance deduction for 1987 of $11,407,401, the 1986 differential earnings amount of

$9,826,925 minus the 1986 recomputed differential earnings amount of negative $1,580,476.

The government denies that AMLI is entitled to subtract the negative $1,580,476 because this will give AMLI deductions greater than its dividends. According to the government, neither the recomputed earnings rate nor the recomputed differential earnings amount can be negative. Thus, AMLI's life insurance deduction for 1987 should be $9,826,925. The government argues that AMLI is attempting to obtain a tax windfall because, while its 1986 dividends are $13,985,737, it is claiming total deductions of $15,566,213 for 1986 ($4,158,812 taken in 1986 and $11,407,401 taken in 1987).

III.

A review of the statute and its legislative history suggests that AMLI is not entitled to deduct an amount greater than its dividends.

1. The purpose of the statute is to reduce mutual companies' deductions by imputing income into dividends that would otherwise be fully deductible. The title of section 809 reflects this purpose: "Reduction in certain deductions of mutual life insurance companies." So does the legislative history. *See* H.R.Rep. No. 432, 98th Cong., pt. 2, at 1422, *reprinted in* 1984 U.S.C.C.A.N. 697, 1067. In addition, section 808 provides that, regarding mutual companies in particular, "the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809." Section 808(c)(2). AMLI's position is that it is entitled to a deduction *enhancement*. The statute and the legislative history suggest otherwise.

2. The statute specifically limits the deduction for policyholder dividends for any taxable year to an amount equal to the policyholder dividends paid or accrued during the taxable year. For mutual companies, this amount should be further reduced according to section 809.

(c) Amount of deduction.—

(1) In general.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.

(2) Reduction in case of mutual companies.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809.

Section 808(c). AMLI's reading of the statute increases its deductions to an amount greater than its dividends for the 1986 tax year. The district court believed that section 808(c) did not apply to limit section 809(f), because the recalculation set forth in section 809(f) was a "life insurance deduction" rather than a deduction for a "policyholder dividend." The district court believed that the 809(f) recalculation was a separate "other deduction" allowed under the catch-all provision of section 805(a)(8).

There is no material distinction between "life insurance deduction" and "policyholder dividend deduction" under the facts of this case. Under section 804, "life insurance deductions" are the general deductions available in section 805. Section 805 provides for several kinds of life insurance deductions, including policyholder dividends that have been calculated under section 808 (c), but specifically provides that "[e]xcept as provided in paragraph (3), no amount shall be allowed as a deduction under this part in respect of policyholder dividends." The 809(f) recalculation simply modifies the section 809 policyholder deduction that was calculated in the prior year, and functions as an adjustment "in respect of policyholder dividends." Hence, the requirements of section 808(c) must apply to section 809.

3. Neither the recomputed differential earnings rate nor the recomputed differential earnings amount should be negative. The negative recomputed differential earnings amount arises here because of the recalculation of the differential earnings rate under 809(c)(1) and (f)(3). The recalculated rate is defined as the "excess" of the imputed earnings rate for the taxable year "over" the average mutual earnings rate for the taxable year. For the tax year 1986, this rate turned out to be negative. AMLI argues that the statute allows for a negative "excess." Indeed, in past years, the Internal Revenue Service acknowledged the possibility of a negative excess.

Congress, however, assumed that the imputed earnings rate (based upon stock company data) would always exceed the average mutual earnings rate. In designing section 809, Congress "determined that the average pretax return on equity of mutual companies falls below that for a comparable group of stock companies." H.R. Rep. No. 432, 98th Cong., pt. 2, at 1422, *reprinted in* 1984 U.S.C.C.A.N. 697, 1067. This is the operative assumption behind the section 809 formula. It turned out to be wrong in 1986 (and, according to the parties, several succeeding years as well). But whether Congress was right or wrong in its assumption, it expected, and thus intended, that "excess" would be a positive number.

The term "excess," moreover, is more susceptible to a reading as a positive number than as a negative number. The statute states that the desired figure is the "excess" of A "over" B. This is the same as asking for the amount by which A exceeds B. If B is greater than A, there is no excess, and the amount by which A exceeds B is zero. AMLI's argument that the concept of "negative excess" has some specialized industry meaning, and that Congress intended that "excess" carry this meaning in section 809, is not convincing. "Language used in tax statutes should be read in the ordinary and natural sense." *Helvering v. San Joaquin Co.*, 297 U.S. 496, 499, 56 S.Ct. 569, 570,

80 L.Ed. 824 (1936). Section 809, moreover, for the reasons already explained, did not anticipate a "negative excess."

4. AMLI asserts that section 809(f) reflects a statistical formula under which mutuals are overtaxed in some years and undertaxed in others. AMLI maintains that Congress envisioned a scheme in which the mutuals' deductions even out in the long run, even if the deductions in any one year are greater than the dividends, because mutuals' deductions are less than the dividends in other years. AMLI points to the rolling three-year average of stock company data used to calculate the imputed stock rate as evidence that this was the congressional intent. This is an intriguing theory, but there is no evidence that this was what Congress had in mind. Rather, it seems more likely that section 809(f) reflects nothing more than a method of evening-up the prior year's incomplete data. *See* H.R.Rep. No. 432, 98th Cong., pt. 2, at 1425, *reprinted in* 1984 U.S.C.C.A.N. 697, 1070. There is no indication whatsoever that it serves any greater purpose as a statistical calculation of earnings trends over time in the life insurance industry. *See id.*

5. After the district court issued its decision, the Internal Revenue Service issued regulations stating that neither the differential earnings rate under section 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under section 809(f)(3) may be less than zero. The regulation is effective for all taxable years beginning after December 31, 1986. *See* 26 C.F.R. § 1.809-9. For the reasons already outlined, this regulation is a reasonable interpretation of the statute. Treasury regulations are entitled to great deference, and must be sustained unless unreasonable and plainly inconsistent with the revenue statutes. *Commissioner v. Portland Cement Company of Utah*, 450 U.S. 156, 169, 101 S.Ct. 1037, 1045,

67 L.Ed.2d 140 (1981). While AMLI objects to the government's reliance on a regulation promulgated since the district court's decision, disregarding the regulation would have availed AMLI nothing. The court's conclusion would have been the same, for the regulation embodies the proper interpretation of the statute.

IV.

For the foregoing reasons, the judgment below is reversed.

APPENDIX B

[Filed Nov. 2, 1993]

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

Civil No. 4-92-70347

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

MEMORANDUM OPINION AND RULINGS

Plaintiff American Mutual Life Insurance Company brings suit for refund of taxes, claiming the Internal Revenue Service has improperly calculated an adjustment to its income under section 809(f)(2) of the Internal Revenue Code. Both parties have moved for summary judgment. The material facts are undisputed, so there is no genuine issue as to any material fact.

Fed. R. Civ. P. 56(c) provides in part: "The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."

UNDISPUTED FACTS

Plaintiff is a mutual life insurance company that writes individual and group life and health insurance policies. It is a calendar year basis taxpayer. The Internal Revenue Code requires such a company to adjust its income each year under provisions designed to tax mutual life insurance companies on a basis similar to that on which stock life insurance companies are taxed.

Stock life insurance companies pay equity returns to shareholders as nondeductible dividends, and dividends to policyholders that are fully deductible as private rebates. Mutual life insurance companies do not have shareholders but only policyholders. Based on the theory that mutual company policyholder dividends include both an equity return and a price rebate, Congress enacted section 809 to place stock and mutual life insurance companies on a comparable footing with respect to the payment of equity returns.

Section 809 requires a comparison between an imputed stock company rate of return before the payment of shareholder dividends (the "imputed earnings rate") and a mutual company rate of return after the payment of policyholder dividends (the "average mutual earnings rate"). Congress assumed that the difference between these two rates was attributable to equity returns distributed to mutual company policyholders and that such difference provided a basis on which to adjust the income of mutual life insurance companies. H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 2, at 1422 (1984); S. Rep. No. 169, 98th Cong., 2d Sess., Vol. I, at 548-49 (1984).

Section 809 requires two computations. In the first of these, under section 809(c), a "differential earnings rate" is computed for each year (*e.g.*, 1986 in this case) based on the difference between the imputed earnings rate for the year (1986) and the average mutual earnings rate for the second preceding year (1984). This rate is multiplied

by a mutual company's "average equity base" for the year (1986) to produce a "differential earnings amount." Under sections 808(c)(2) and 809(a)(1), this amount affects taxable income for the year (1986) by adjusting the section 808 policyholder dividends deduction (and, if the differential earnings amount is greater than the policyholder dividends paid, by adjusting the closing balance of reserves pursuant to section 809(a)(2)).

In the second computation, under section 809(f)(3), a "recomputed differential earnings rate" and a "recomputed differential earnings amount" are computed for the following year (1987) based on the difference between the imputed earnings rate for the prior year (1986) and the average mutual earnings rate for the prior year (1986). The recomputed differential earnings amount (for 1986) is compared to the differential earnings amount (for 1986) and, as relevant here, under section 809(f)(2), the excess of the latter over the former is allowed as a "life insurance deduction" in the following year (1987).

Additional complexity results from the fact that section 809 requires a comparison of stock and mutual earnings rates for different years. Thus, while the average mutual earnings rate for a year (*e.g.*, 1986) reflects mutual company rates of return for that year, the imputed earnings rate for that same year is instead based upon an average of stock company rates of return for the three immediately preceding years (1983, 1984 and 1985).[1]

---

[1] Under section 809(d)(1)(B), the imputed earnings rate for a year equals the average of the stock earnings rates for the three preceding years times the ratio of 16.5 percent to the average of the stock earnings rates for the years 1981, 1982, and 1983. In Revenue Ruling 86-114, 1987-2 C.B. 96, the Internal Revenue Service announced its determination that the average of the stock earnings rates for the years 1981, 1982, and 1983 is 18.221 percent. Accordingly, the formula specified by the statute produces a ratio of 90.55 percent.

On its federal income tax return for 1986, plaintiff reported a 1986 differential earnings amount of $9,826,925.[2] Pursuant to sections 808(c)(2) and 809(a)(1), plaintiff reduced its section 808 policyholder dividends deduction for 1986 by that differential earnings amount, from $13,985,737 to $4,158,812. This computation is not in dispute.

For 1987, plaintiff claims a 1986 recomputed differential earnings amount of *minus* $1,580,476.[3] Relying on section 809(f)(2), plaintiff claims a life insurance deduction for 1987 of $11,407,401, calculated as the difference between the 1986 differential earnings amount of $9,826,925 and the 1986 recomputed differential earnings amount of —$1,580,476.

Plaintiff reported a net operating loss for the 1987 tax year that it carried back to 1984 and made a tentative claim for refund under IRC § 6411 for that year, which was granted by the Internal Revenue Service.

On July 3, 1991, subsequent to an examination by the Internal Revenue Service, a delegate of the Secretary of the Treasury assessed corporate income tax deficiencies against plaintiff relative to the 1984 tax year in the amounts of $580,865 and $164,220, which represent assessed tax and interest respectively. These amounts were fully paid to the United States by plaintiff.

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[2] The 1986 differential earnings amount was calculated by multiplying the 1986 "differential earnings rate" of 10.539 percent by plaintiff's 1986 "average equity base" of $93,243,430. The 1986 differential earnings rate was calculated as the difference between the 1986 imputed earnings rate (16.285 percent) and the 1984 average mutual earnings rate (5.746 percent).

[3] The 1986 recomputed differential earnings amount was calculated by multiplying the 1986 "recomputed differential earnings rate" of −1.695 percent by plaintiff's 1986 average equity base of $93,243,430. The 1986 recomputed differential earnings rate was calculated as the difference between the 1986 imputed earnings rate (16.285 percent) and the 1986 average mutual earnings rate (17.980 percent).

On September 27, 1991, plaintiff filed a claim for refund relative to the taxable year 1984 seeking $729,163 in tax, plus assessed and statutory interest. This claim for refund was denied by the Internal Revenue Service and resulted in this lawsuit. Subsequent to the filing of this lawsuit, plaintiff revised its claim for refund downward to the amount of $668,857 plus assessed and statutory interest.

The Issue

The Internal Revenue Service denies $1,580,476 of plaintiff's 1987 life insurance deduction, asserting that the deduction must be limited to plaintiff's 1986 differential earnings amount of $9,826,925, *i.e.*, the amount by which plaintiff reduced its section 808 policyholder dividends deduction for 1986. Plaintiff claims entitlement to the full amount of the $11,407,401 life insurance deduction that it computed under section 809(f)(2) for 1987.

DISCUSSION

The parties are in agreement that the formula contained in section 809(c)(1) and 809(f)(3) yields a 1986 recomputed differential earnings rate of —1.695 percent and, in turn, a 1986 recomputed differential earnings amount of —$1,580,476.[4] Plaintiff contends that, from this, it necessarily follows under the statute that it is entitled to deduct $11,407,401 for 1987 under section 809(f)(2).

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[4] In Announcement 88-47, 1988-12 I.R.B. 56, the Internal Revenue Service announced its decision that the 1986 recomputed differential earnings rate, based on a tentative data compilation, was "—1.700" percent. In Proposed Treasury Decision FI-159-84, 57 Fed. Reg. 37,495 (1992), citing its prior Notice 88-106, 1988-2 C.B. 444, the Internal Revenue Service stated that it considered the 1986 recomputed differential earnings rate to be zero, "even though the calculated rate was negative." In its briefs in this case, and at oral argument, defendant conceded that the formula contained in section 809(c)(1) and 809(f)(3) produces a negative 1986 recomputed differential earnings rate and a negative 1986 recomputed differential earnings amount.

Section 809(f)(2) provides that where

> (A) the differential earnings amount determined under this section for any taxable year, exceeds
>
> (B) the recomputed differential earnings amount for such taxable year,
>
> such excess shall be allowed as a life insurance deduction for the succeeding taxable year.

Here, the 1986 differential earnings amount of $9,826,925 exceeds the 1986 recomputed differential earnings amount of —$1,580,476 by $11,407,401. The language of section 809(f)(2) provides that "such excess shall be allowed as a life insurance deduction" for 1987. This language on its face unambiguously provides for a life insurance deduction of $11,407,401.

Defendant contends, however, that section 808(c) should be read together with section 809(f)(2), and that the former provision limits the deduction otherwise allowable under the latter. Section 808(c) provides as follows:

> (c) AMOUNT OF DEDUCTION.—
>
> (1) IN GENERAL.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.
>
> (2) REDUCTION IN CASE OF MUTUAL COMPANIES.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be *reduced* by the amount determined under section 809. [Emphasis supplied.]

According to defendant, section 808(c)(2), due to its use of the word "reduced," prevents a negative differential earnings amount from increasing the policyholder

dividends deduction for one year, and also, by implication, limits the section 809(f)(2) deduction for the following year to the amount of the prior year's differential earnings amount.

Defendant's assertion that section 808(c) should be read into section 809(f)(2), however, disregards the statutory language. The section 809(f)(2) "life insurance deduction" at issue in this case is not a section 808 deduction for policyholder dividends allowable under section 805(a)(3), but, rather, is one of the "other deductions" allowable under section 805(a)(8). Thus, even if, as defendant contends, section 808(c) were to operate to impose a limitation on the amount of policyholder dividends deductible, that provision would not operate to limit the amount of the section 809(f)(2) deduction here at issue.[5] To read section 808(c) into section 809(f)(2), as defendant asks the court to do, would effectively rewrite the statute. It is for Congress, not the courts, to rewrite statutes.

If Congress had intended that the section 809(f)(2) life insurance deduction be limited by section 808(c), it could have expressly qualified section 809(f)(2) to achieve that result. For example, Congress could have added to the provision the final clause, "but the amount of such deduction for the year shall not exceed the differential earnings amount for the preceding taxable year." The statutory language, however, contains no limitation on the amount deductible under section 809(f)(2). The legislative history also indicates that no limitation was intended, providing that "any difference" between the differential earnings amount and the recomputed differential earnings amount is allowable as a life insurance deduction. H.R. Rep. No. 432, *supra*, at 1425; S. Rep. No. 169, *supra*, at 552.

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[5] This case does not involve a deduction for policyholder dividends and, thus, whether section 808(c) prevents recognition of a negative differential earnings amount is not before the court.

The court finds defendant's "whole law" argument and its argument that Congress intended to raise a certain amount of revenue from mutual and stock life insurance companies for the years 1984 through 1988 unpersuasive.

The court concludes that plaintiff is entitled to deduct $11,407,401 as a section 809(f)(2) life insurance deduction for 1987, rather than the $9,826,925 already allowed by defendant.

RULINGS

The motion for summary judgment filed by plaintiff on March 31, 1993, is **GRANTED.**

The motion for summary judgment filed by defendant on April 1, 1993, is **DENIED.**

Counsel for plaintiff is directed to promptly submit a proposed order for judgment.

DATED this 2nd day of November, 1993.

/s/ Harold D. Vietor
HAROLD D. VIETOR
United States District Judge

APPENDIX C

[Filed Dec. 9, 1993]

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

Case Number: 4-92-cv-70347

AMERICAN MUTUAL LIFE INSURANCE COMPANY AND SUBSIDIARIES,
Plaintiff

v.

UNITED STATES OF AMERICA,
Defendant.

AMENDED JUDGMENT IN CIVIL CASE

— **JURY** Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

X **Decision by Court.** This action came to consideration before the Court. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED:

Judgment is entered in favor of the plaintiff, American Mutual Life Insurance Company and Subsidiaries, and against the defendant, the United States of America, in the amount of Six Hundred Sixty-Eight Thousand Eight Hundred Fifty-Seven Dollars ($668,857.00) of tax and One Hundred Sixty-Four Thousand Two Hundred Twenty

Dollars and Eighty-Seven Cents ($164,220.87) of interest paid, plus statutory interest thereon according to law.

Date December 9, 1993

JAMES R. ROSENBAUM
Clerk

/s/ [Illegible]
(By) Deputy Clerk

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 94-1440SIDM

AMERICAN MUTUAL LIFE INSURANCE COMPANY
AND SUBSIDIARIES,
Appellee,

VS.

UNITED STATES OF AMERICA,
Appellant.

THE STOCK COMPANY INFORMATION GROUP,
Amicus Curiae.

Appeal from the United States District Court
for the Southern District of Iowa

The suggestion for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

Judge Hansen took no part in the consideration or decision of this case.

March 21, 1995

Order Entered at the Direction of the Court:

/s/ Michael E. Gans
Clerk
U.S. Court of Appeals
Eighth Circuit

APPENDIX E

STATUTORY APPENDIX

INTERNAL REVENUE CODE OF 1986 (26 U.S.C.):

§ 801. TAX IMPOSED.

(a) TAX IMPOSED.—

(1) IN GENERAL.—A tax is hereby imposed for each taxable year on the life insurance company taxable income of every life insurance company. Such tax shall consist of a tax computed as provided in section 11 as though the life insurance company taxable income were the taxable income referred to in section 11.

* * * *

(b) LIFE INSURANCE COMPANY TAXABLE INCOME.—For purposes of this part, the term "life insurance company taxable income" means—

(1) life insurance gross income, reduced by

(2) life insurance deductions.

* * * *

§ 803. LIFE INSURANCE GROSS INCOME.

(a) IN GENERAL.—For purposes of this part, the term "life insurance gross income" means the sum of the following amounts:

(1) PREMIUMS.—

(A) The gross amount of premiums and other consideration on insurance and annuity contracts, less

(B) return premiums, and premiums and other consideration arising out of indemnity reinsurance.

(2) DECREASES IN CERTAIN RESERVES.—Each net decrease in reserves which is required by section 807(a) to be taken into account under this paragraph.

(3) OTHER AMOUNTS.—All amounts not includible under paragraph (1) or (2) which under this subtitle are includible in gross income.

* * * *

§ 804. LIFE INSURANCE DEDUCTIONS.

For purposes of this part, the term "life insurance deductions" means—

(1) the general deductions provided in section 805, and

(2) the small life insurance company deduction (if any) determined under section 806(a) . . .

* * * *

§ 805. GENERAL DEDUCTIONS.

(a) GENERAL RULE.—For purposes of this part, there shall be allowed the following deductions:

* * * *

(2) INCREASES IN CERTAIN RESERVES.—The net increase in reserves which is required by section 807(b) to be taken into account under this paragraph.

(3) POLICYHOLDER DIVIDENDS.—The deduction for policyholder dividends (determined under section 808(c)).

* * * *

(8) OTHER DEDUCTIONS.—Subject to the modifications provided by subsection (b), all other deductions allowed under this subtitle for purposes of computing taxable income.

Except as provided in paragraph (3), no amount shall be allowed as a deduction under this part in respect of policyholder dividends.

§ 807. RULES FOR CERTAIN RESERVES.

(a) DECREASE TREATED AS GROSS INCOME.—If for any taxable year—

(1) the opening balance for the items described in subsection (c), exceeds

(2)(A) the closing balance for such items, reduced by

(B) the sum of (i) the amount of the policyholders' share of tax-exempt interest, plus (ii) any excess described in section 809(a)(2) for the taxable year,

such excess shall be included in gross income under section 803(a)(2).

(b) INCREASE TREATED AS DEDUCTION.—If for any taxable year—

(1)(A) the closing balance for the items described in subsection (c), reduced by

(B) the sum of (i) the amount of the policyholders' share of tax-exempt interest, plus (ii) any excess described in section 809(a)(2) for the taxable year, exceeds

(2) the opening balance for such items,

such excess shall be taken into account as a deduction under section 805(a)(2).

* * * *

§ 808. POLICYHOLDER DIVIDENDS DEDUCTION.

(a) POLICYHOLDER DIVIDEND DEFINED.—For purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.

(b) CERTAIN AMOUNTS INCLUDED.—For purposes of this part, the term "policyholder dividend" includes—

(1) any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management,

(2) excess interest,

(3) premium adjustments, and

(4) experience-related refunds.

(c) AMOUNT OF DEDUCTION.—

(1) IN GENERAL.—Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.

(2) REDUCTION IN CASE OF MUTUAL COMPANIES.—In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced by the amount determined under section 809.

* * * *

§ 809. REDUCTION IN CERTAIN DEDUCTIONS OF MUTUAL LIFE INSURANCE COMPANIES.

(a) GENERAL RULE.—

(1) POLICYHOLDER DIVIDENDS.—In the case of any mutual life insurance company, the amount of the deduction allowed under section 808 shall be reduced (but not below zero) by the differential earnings amount.

(2) REDUCTION IN RESERVE DEDUCTION IN CERTAIN CASES.—In the case of any mutual life insurance company, if the differential earnings amount exceeds the amount allowable as a deduction under section 808 for the taxable year (determined without regard

to this section), such excess shall be taken into account under subsections (a) and (b) of section 807.

(3) DIFFERENTIAL EARNINGS AMOUNT.—For purposes of this section, the term "differential earnings amount" means, with respect to any taxable year, an amount equal to the product of—

(A) the life insurance company's average equity base for the taxable year, multiplied by

(B) the differential earnings rate for such taxable year.

(b) AVERAGE EQUITY BASE. For purposes of this section—

(1) IN GENERAL.—The term "average equity base" means, with respect to any taxable year, the average of—

(A) the equity base determined as of the close of the taxable year, and

(B) the equity base determined as of the close of the preceding taxable year.

(2) EQUITY BASE.—The term "equity base" means an amount determined in the manner prescribed by regulations equal to—

(A) the surplus and capital,

(B) adjusted as provided in paragraphs (3), (4), (5), and (6) of this subsection.

No item shall be taken into account more than once in determining equity base.

(3) INCREASE FOR NONADMITTED FINANCIAL ASSETS.—

(A) IN GENERAL.—The amount of the surplus and capital shall be increased by the amount of the nonadmitted financial assets.

(B) NONADMITTED FINANCIAL ASSETS.—For purposes of subparagraph (A), the term "nonadmitted financial asset" means any nonadmitted asset of the company which is—

(i) a bond,

(ii) stock,

(iii) real estate,

(iv) a mortgage loan on real estate, or

(v) any other invested asset.

(4) INCREASE WHERE STATUTORY RESERVES EXCEED TAX RESERVES.—

(A) IN GENERAL.—If—

(i) the aggregate amount of statutory reserves, exceeds

(ii) the aggregate amount of tax reserves, the amount of the surplus and capital shall be increased by the amount of such excess.

(B) DEFINITIONS.—For purposes of this paragraph—

(i) STATUTORY RESERVES.—The term "statutory reserves" means the aggregate amount set forth in the annual statement with respect to items described in section 807(c). Such term shall not include any reserve attributable to a deferred and uncollected premium if the establishment of such reserve is not permitted under section 811(c).

(ii) TAX RESERVES.—The term "tax reserves" means the aggregate of the items

described in section 807(c) as determined for purposes of section 807.

(5) INCREASE BY AMOUNT OF CERTAIN OTHER RESERVES.—The amount of the surplus and capital shall be increased by the sum of—

(A) the amount of any mandatory securities valuation reserve,

(B) the amount of any deficiency reserve, and

(C) the amount of any voluntary reserve or similar liability not described in subparagraph (A) or (B).

(6) ADJUSTMENT FOR NEXT YEAR'S POLICYHOLDER DIVIDENDS.—The amount of the surplus and capital shall be increased by 50 percent of the amount of any provision for policyholder dividends (or other similar liability) payable in the following taxable year.

(c) DIFFERENTIAL EARNINGS RATE.—

(1) IN GENERAL.—For purposes of this section, the differential earnings rate for any taxable year is the excess of—

(A) the imputed earnings rate for the taxable year, over

(B) the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

(2) TRANSITIONAL RULE.—The differential earnings rate—

(A) for any taxable year beginning in 1984, or

(B) for purposes of computing the amount of underpayment under section 6655 (includ-

ing the application of section 6655(d)(3)) for any taxable year beginning in 1985,

shall be equal to 7.8 percent.

(3) COORDINATION WITH ESTIMATED TAX PAYMENTS.—For purposes of applying section 6655 with respect to any installment of estimated tax, the amount of tax shall be determined by using the lesser of—

(A) the differential earnings rate of the second tax year preceding the taxable year for which the installment is made, or

(B) the differential earnings rate for the taxable year for which the installment is made.

(d) IMPUTED EARNINGS RATE.—

(1) IN GENERAL.—For purposes of this section, the imputed earnings rate for any taxable year is—

(A) 16.5 percent in the case of taxable years beginning in 1984, and

(B) in the case of taxable years beginning after 1984, an amount which bears the same ratio to 16.5 percent as the current stock earnings rate for the taxable year bears to the base period stock earnings rate.

(2) CURRENT STOCK EARNINGS RATE.—For purposes of this subsection, the term "current stock earnings rate" means, with respect to any taxable year, the average of the stock earnings rates determined under paragraph (4) for the 3 calendar years preceding the calendar year in which the taxable year begins.

(3) BASE PERIOD STOCK EARNINGS RATE.—For purposes of this subsection, the base period stock earnings rate is the average of the stock earnings

rates determined under paragraph (4) for calendar years 1981, 1982, and 1983.

(4) STOCK EARNINGS RATE.—

(A) IN GENERAL.—For purposes of this subsection, the stock earnings rate for any calendar year is the numerical average of the earnings rates of the 50 largest stock companies.

(B) EARNINGS RATE.—For purposes of subparagraph (A), the earnings rate of any stock company is the percentage (determined by the Secretary) which—

(i) the statement gain or loss from operations for the calendar year of such company, is of

(ii) such company's average equity base for such year.

(C) 50 LARGEST STOCK COMPANIES.—For purposes of this paragraph, the term "50 largest stock companies" means a group (as determined by the Secretary) of stock life insurance companies which consists of the 50 largest domestic stock life insurance companies which are subject to tax under this part. The Secretary—

(i) shall, for purposes of determining the base period stock earnings rate, exclude from the group determined under the preceding sentence any company which had a negative equity base at any time during 1981, 1982, or 1983,

(ii) shall exclude from such group for any calendar year any company which has a negative equity base, and

(iii) may by regulations exclude any other company which otherwise would

have been included in such group if the inclusion of the excluded company or companies would, by reason of the small equity base of such company, seriously distort the stock earnings rate.

The aggregate number of companies excluded by the Secretary under clause (iii) shall not exceed the excess of 2 over the number of companies excluded under clause (ii).

(D) TREATMENT OF AFFILIATED GROUPS.—For purposes of this paragraph, all stock life insurance companies which are members of the same affiliated group shall be treated as one stock life insurance company.

(e) AVERAGE MUTUAL EARNINGS RATE.—For purposes of this section, the average mutual earnings rate for any calendar year is the percentage (determined by the Secretary) which—

(1) the aggregate statement gain or loss from operations for such year of domestic mutual life insurance companies, is of

(2) their aggregate average equity bases for such year.

(f) RECOMPUTATION IN SUBSEQUENT YEAR.—

(1) INCLUSION IN INCOME WHERE RECOMPUTED AMOUNT GREATER.—In the case of any mutual life insurance company, if—

(A) the recomputed differential earnings amount for any taxable year, exceeds

(B) the differential earnings amount determined under this section for such taxable year,

such excess shall be included in life insurance gross income for the succeeding taxable year.

(2) DEDUCTION WHERE RECOMPUTED AMOUNT SMALLER.—In the case of any mutual life insurance company, if—

(A) the differential earnings amount determined under this section for any taxable year, exceeds

(B) the recomputed differential earnings amount for such taxable year,

such excess shall be allowed as a life insurance deduction for the succeeding taxable year.

(3) RECOMPUTED DIFFERENTIAL EARNINGS AMOUNT.—For purposes of this subsection, the term "recomputed differential earnings amount" means, with respect to any taxable year, the amount which would be the differential earnings amount for such taxable year if the average mutual earnings rate taken into account under subsection (c)(1)(B) were the average mutual earnings rate for the calendar year in which the taxable year begins.

(4) SPECIAL RULE WHERE COMPANY CEASES TO BE MUTUAL LIFE INSURANCE COMPANY.—Except as provided in section 381(c)(22), if—

(A) a life insurance company is a mutual life insurance company for any taxable year, but

(B) such life insurance company is not a mutual life insurance company for the succeeding taxable year,

any adjustment under paragraph (1) or (2) by reason of the recomputed differential earnings amount for the first of such taxable years shall be taken into account for the first of such taxable years.

(5) SUBSECTION NOT TO APPLY FOR PURPOSES OF ESTIMATED TAX.—Section 6655 shall be applied to any taxable year without regard to any adjustment under this subsection for such year.

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TREASURY REGULATIONS ON INCOME TAX (26 C.F.R.):

§ 1.809-9. Computation of the differential earnings rate and the recomputed differential earnings rate.

(a) *In general.* Neither the differential earnings rate under section 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under section 809(f)(3) may be less than zero.

(b) *Definitions*—(1) *Recomputed differential earnings amount.* The recomputed differential earnings amount, with respect to any taxable year, is the amount equal to the product of—

(i) The life insurance company's average equity base for the taxable year; multiplied by

(ii) The recomputed differential earnings rate for that taxable year.

(2) *Recomputed differential earnings rate.* The recomputed differential earnings rate for any taxable year equals the excess of—

(i) The imputed earnings rate for the taxable year; over

(ii) The average mutual earning rate for the calendar year in which the taxable year begins.

(c) *Effective date.* The regulations are effective for all taxable years beginning after December 31, 1986.